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1 February 2018

Theo Kelly
Australian Competition and Consumer Commission
Level 2
23 Marcus Clarke Street
Canberra ACT 2601

Dear Theo

Central and Macquarie Mereenie - response to queries from the ACCC

I refer to the email from Gavin McNeil dated 14 December 2017 which requested further information from Central Petroleum Limited and Central Petroleum Mereenie Pty Ltd as trustee for the Central Petroleum Mereenie Unit Trust (together, ***Central***) and Macquarie Mereenie Pty Ltd (***Macquarie Mereenie***), together the ***Applicants***, regarding the application for authorisation and interim authorisation of Mereenie natural gas joint marketing arrangements.

On behalf of the Applicants, please find below answers to each of those ACCC queries.

For ease of reference, we have repeated the ACCC's specific queries below and inserted the Applicants responses below each of them.

[redacted]

Introductory comments

It appears from the tenor of the ACCC's questions that the ACCC has some uncertainty about the veracity of the statements in previous submissions that the Mereenie stairway development is dependent on the joint marketing conduct sought to be authorised.

The Applicant's continue to consider that dependency remains.

The context for the proposed joint marketing remains that:

- the Mereenie joint venture contains a contractual Production Limited on the venturers, which was designed to reflect the operational limited on the field (whereby production beyond that limited would adversely impact on overall production from the field);
- Central as the more cash constrained of the two participants and the participant that is dependent on gas sales to underwrite its ongoing financing arrangements, has rapidly sold up to the Production Limit, such that it can no longer make any further sales without both:
    - A change to the joint venture arrangements to increase the Production Limit; and

- Further appraisal and production drilling and upgrade to Mereenie field facilities to operationally allow greater production.

- The amount of required fresh capital is very significant (estimated to be [redacted] in appraisal drilling followed by a further [redacted] in capital). That capital is necessary for the development of the Mereenie field and upgrade of related facilities to the point which it can supply industrial customers via the Northern Gas Pipeline at the required rate / volumes and to develop the reserves to support the longer contract terms customers are anticipated to be seeking;
- The parties are having to consider investment of that significant capital against the backdrop of:
  - significant regulatory uncertainty – with the Northern Territory's continued consideration of excluding the Northern Territory gas pipeline network from the national gas pipeline regulation reforms, including in relation to issues that impact on gas balancing and marketing like whether the 'next day auction' process would apply ;
  - an illiquid and immature market for sales from the Northern Territory to the East Coast;
  - the existing imbalance of sales and production – which creates a misalignment of economic incentives to proceed with investment, and has led to joint venture approval not being forthcoming for the development in the absence of the ACCC authorisation that is being sought.
- Without the joint marketing sought to be authorised, the only way to align incentives is to defer investment in the field until it is required for the sales profile of the slower participant to sell its volume – at which point the opportunity to have gas for the first operations of the Northern Gas Pipeline will have long since ceased, and future investments will only be able to be made in inefficient increments to support incremental sales.

The Applicants continue to believe that the proposed joint marketing will provide the only way to align their economic incentives in order to allow the participants (Macquarie Mereenie in particular) to justify the significant fresh capital required, proceed with the desired efficient investments in the Mereenie field and ultimately meet the needs of East Coats gas customers – all of which will deliver the clear public benefits outlined in the Applicants' earlier submissions.

1. Para 10(1)(f)(c) of the 10 November submission states:

"the Applicants have 150 PJ of existing 2P gas reserves at Mereenie that authorisation would facilitate being brought to market by allowing the production limits to be lifted (given the commercial certainty that joint marketing would bring)."

Please outline:

(a) Whether these 2P gas reserves are the subject of any existing gas supply arrangements.

The 150PJ referenced in the previous submission was derived from the current reserves statement of Central for Mereenie as detailed in Central's ASX announcement dated 14 March 2016.[1] That reserves statement estimated Mereenie sales gas reserves and contingent resources as of 31 December 2015.

51.2 PJ of the 150 PJ is or has become subject to gas supply arrangements from 1 January 2016 with the balance not currently the subject of any existing gas supply arrangements.

However, as discussed in the Applicants' earlier submissions:

[1] Accessible at http://www.asx.com.au/asxpdf/20160314/pdf/435t73gj0w8d1c.pdf

- Central has already sold up to the Production Limit provided for the in the joint venture arrangements, such that even though there are 2P reserves that are uncontracted Central cannot currently supply gas from its proportion of those reserves; and
- the Production Limit and the operational limitations of the Mereenie field and facilities impose contractual and operational limits respectively on the rate at which Macquarie Mereenie would be able to supply gas from its proportion of the uncontracted reserves.

(b) What additional investment or development is required to be in a position to supply gas from these 2P gas reserves to customers?

[redacted]

(c) What changes would be needed (if any) to the current joint venture arrangements and agreements to bring this gas to market?

As Central has fully contracted supply up to the Production Limit, it is precluded from making any further sales of Mereenie gas without amendments to the joint venture arrangements to change the Production Limit.

However, as noted above, the Production Limit was imposed as a consequence of the field and facility limitations – such that making sales above the Production Limit is not just a matter of joint venture changes - further investment is also required.

The Production Limit is based on the optimal production parameters of the Mereenie field so that increased gas production by a party (through its own individual gas sales above its 50% participating interest) would not adversely impact the other party's oil and gas production (and related revenues).

In particular, the Production Limit has ensured the Mereenie field operated in accordance with good oilfield practice and well conservation principles particularly as gas flow above the Production Limit:

(i) affects reliability of the installed plant;

(ii) reduces oil production of the field (hence revenues) as raw gas is reinjected to support the reservoir for oil production; and

(iii) adversely impacts sales gas quality as the Production Limit avoids the need to bring on high nitrogen content wells for production.

Operating the field at a rate greater than the Production Limit will adversely affect Mereenie oil and gas production without further investment of the Mereenie JV Participants as described in the answer to question 2(b) above.

Accordingly the changes to the joint venture arrangements would be to increase the Production Limit to take into account the ability of the Mereenie field to operate at a new higher production level (after development) to support jointly marketed new gas supplies.

As noted in the Applicants' earlier submissions, the Applicants do not have aligned economic incentives to pursue such further investment without the joint marketing sought to be authorised.

Whilst Macquarie Mereenie is not prohibited from bringing gas to market solely, this opportunity has not been pursued to date because:

- Macquarie Mereenie is also restricted by the Production Limit (and operational limitations of the field and facilities), which inhibits the rate at which supply can occur;
- East coast industrial gas customers are seeking a larger volume of gas, at a larger flow rate, for a longer period, than Macquarie Mereenie can supply alone;
- East coast gas customers are seeking 'single source solutions' – and are likely to be less interested in the lower level of certainty that comes with contracting with only one joint venture participant; and
- the market for export of Northern Territory gas into the East coast gas market is relatively immature and illiquid and separate marketing is not regarded as viable.

(d) Whether these 2P reserves are intended to be sold by the joint venture parties as part of the proposed joint marketing arrangements.

[redacted]

2. Para 5.2(b) of the 24 November submission states:

"...the drilling of the two wells at the Mereenie field are still awaiting Mereenie joint venture approval, a decision on which has been put on hold pending the outcome of the ACCC's decision on interim authorisation"

[redacted]

Please provide:

(a) A copy of the investment proposal/report (or similar document) presented to the joint venture for approval.

[redacted]

(b) The timeframe of when the proposal was put to the joint venture for approval.

[redacted]

3. Please provide, for both Central Petroleum and Macquarie:

(a) Any internal documents regarding the appraisal drilling program (as referred to in 4.4 of the Application for Authorisation dated 4 October 2017 and the need for joint marketing.

Please find enclosed:

[redacted]

For completeness we have also included the various public documents produced by Central which have consistently indicated the need for joint marketing over a sustained period (including prior to the authorisation application being made to the ACCC).

Those documents include those produced to the court as part of a proposed Scheme of Arrangement (in relation to Macquarie's bid for Central) and to the market through ASX disclosures. As you would be aware, disclosures in both of those contexts carry legal obligations to be accurate and not misleading. In particular, the Applicants would draw the ACCC's attention to the following documents and statements:

Date	Document	Reference
31 May 2017	Supreme Court of Queensland approved Supplementary Scheme Booklet as announcement to the ASX	Page 3 states that a Gas Sales Agreement entered into with EDL "completes Central's gas sales capacity from Mereenie under the Interim Gas Balancing Agreement negotiated with Santos on Central's acquisition of Mereenie and inherited by Macquarie Mereenie. This effectively precludes any additional Central-only gas sales from Mereenie until a permanent marketing arrangement is negotiated with Macquarie Mereenie as Central's Mereenie joint venture partner." Page 3 section 2.2 "All activities at Mereenie can only be carried out pursuant to an approved joint venture budget unless a joint venturer elects to sole-risk (i.e. at that party's sole cost) a particular project. The joint venture agreement was negotiated with Santos and has not been amended since the sale of its interest to Macquarie Mereenie. As a 50:50 joint venture, both joint venture parties have a veto on the joint venture budget other than those expenditures required by law. If a party acting in its own commercial interest wants to sole risk a project, for example, aimed at maximising the gas available for delivery into the east coast gas market on the commissioning of the Northern Gas Pipeline (NGP), the other party will need to elect to participate (taking into account, in Central's case, the financial impact of such participation on its loan covenants) or not participate and suffer the resulting dilution of its percentage of sales gas available as a result of such a project." Page 4 section 2.4 "As neither Macquarie Mereenie (nor Santos before that) has used a material portion of their entitlement under the Mereenie Interim Gas Balancing Agreement, Macquarie Mereenie has substantial volumes of gas to sell under that arrangement. Since the Interim Gas Balancing is a limit on total sales for each joint venturer, such sales do not contractually re-set or re-balance Central's over lift, i.e. these sales do not enable Central to re-commence gas sales from Mereenie unilaterally. It was always envisaged with Santos that eventually there would be a marketing arrangement agreement negotiated, hence the word "interim". The value ascribed to Central by the Independent Expert has assumed that further volumes can be sold (i.e. this hurdle will be overcome) but given the change in joint venture arrangements this, as yet, is not assured."
10 August 2017	ASX Announcement titled CENTRAL PETROLEUM ANNOUNCES A$27m EQUITY RAISING TO SUPPORT GAS ACCELERATION PROGRAMME	Pages 2 and 3 "The Equity Raising will facilitate a drilling programme that, if successful, will allow Central to increase total Reserves and position itself to further capitalise on the completion of construction of the Northern Gas Pipeline during the 2nd half of 2018." Gas is already known to exist in each of the four targets and a

		substantial amount of fracture modelling work has been carried-out in order to identify the target well locations. Subject to joint venture approvals and funding, we expect all four targets will be ready for execution by the fourth quarter".
10 August 2017	ASX Announcement presentation titled "Equity Raising CLOSING THE GAP (Gas Acceleration Programme) Mitigating the Australian Energy Crisis"	Page 14 "Closing the GAP | Negotiations are progressing satisfactorily for gas marketing arrangements for Mereenie so that, when we decide to Close the GAP, there can be quick commercialisation". Page 15 "Mereenie marketing agreements | Central continues to work towards negotiating a mutually acceptable pathway with our Mereenie joint venturer, Macquarie, to effectively commercialise the Mereenie gas reserves"
26 September 2017	ASX Announcement presentation	Slide 10 titled "Milestones – CTP is perfectly positioned" where 2017 Q4 "Interim approval from ACCC" is required with "JV approval for Mereenie Campaign".
31 January 2017	ASX Announcement - Managing Director's Report to Shareholders for the Quarter	Page 2 "Central and its Mereenie Joint Venture Partner are awaiting a decision by the ACCC on its application for joint marketing before formal active gas marketing can commence. A decision is expected soon. However, as Joint Venture approval is conditional on ACCC clearance for joint marketing, the sequencing of the drilling programme may need to be altered to accommodate the delay in the ACCC decision."

(b) Any internal or commissioned documents regarding the merits or feasibility of entering into a gas balancing arrangement to manage the supply of jointly produced gas under a separate marketing arrangement.

The Applicants do not believe that any such documents exist.

However, commercial personnel for both Central and Macquarie Mereenie hold the clear view that this would not be feasible because:

- in an illiquid and immature market, attempting to separately market gas is likely to result in substantial commercial risks (including due to issues associated with gas balancing);
- there is significant regulatory uncertainty in relation to future regulation of the Northern Gas Pipeline and Northern Territory gas pipeline network – including in relation to issues like the 'next day auction' process would apply (which again makes it very difficult to design a gas balancing arrangements);
- it is anticipated that East Coast gas customers for Northern Territory gas would be seeking longer term contracts for higher volumes / rates of supply than Macquarie Mereenie can supply alone based on the current operational and contractual limits;
- the parties have misaligned interests such that approval for further investment to increase the production and supply potential of the field is highly unlikely without joint marketing; and
- even if separate marketing was to somehow be viable, those commercial risks and potential for divergent investment incentives between the joint venturers means that separate marketing is likely to result in deferral or withdrawal of planned investment (including non-approval of the Mereenie stairway drilling) until the point where it is required for the slower selling participant - such that the market without joint marketing is likely to involve lower volumes of supply (effectively constraining supply to that limited gas Macquiare Mereenie gas that can theoretically be marketed separately).

The Applicants hope those responses assist the ACCC in finalising their consideration of the authorisation application as swiftly as possible, as it is not viable for the participants to continue to defer the decisions on the Mereenie appraisal drilling as is currently occurring.

As always, please do not hesitate to contact me if you would like to discuss any of the above.

Yours sincerely

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